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SUBJECT: Interest Rises in Mongolian Uranium Deposits

REFS: (A) 06 Ulaanbaatar 870 (NOTAL), (B) Ulaanbaatar 216 (NOTAL)

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¶1. (SBU) SUMMARY: Current estimates, mostly based on Soviet era surveys, place Mongolia's current commercial recoverable reserves of yellowcake at some two million metric tons, but Mongolian officials believe that the actual totals may be much higher. Rising prices for uranium have reignited interest in Mongolia's resources. With other partners, an American company says it hopes to begin producing yellowcake in two years. Russia has recently attempted to reenter Mongolia by offering possible exploration, processing, and power generation rights. The GOM believes that Western miners would best ensure uranium mining will be environmentally sensitive and offer value-added returns to Mongolia. Miners are concerned about the GOM's desire to take an equity share of uranium prospects. A disorganized administrative structure that atomizes regulatory and administrative responsibilities among competing agencies complicates matters. Although the GOM recognizes its non-proliferation obligations under the numerous conventions and treaties to which it is a signatory, the GOM has yet to formally consider the practical implications of these obligations as they apply to the wide-scale production of uranium products in Mongolia. This report offers a preliminary snapshot of Mongolia's uranium prospects and existing regulations and controls. **END SUMMARY.**

Status and Amounts of Uranium Deposits

¶2. (U) While Mongolia's world class copper, gold, and coal deposits have received much attention, the number of uranium prospects (i.e., exploration sites) is also significant. Currently, uranium reserves are known in the eastern province of Dornod and some possible deposits in the south Gobi desert region. Based primarily on Russian assessments from the mid-1960s through late 1980s, the GOM estimates total Dornod eastern steppe reserves may reach some 500,000 MT of yellowcake. The same studies suggested that the South and Central Gobi Regions might contain some 1.5 million MT of yellowcake. However, Mongolian officials assert that only 30% of Mongolia's territory has been surveyed for uranium and that these studies were Soviet era surveys using obsolete technology. In fact, some Mongolian officials think that Mongolia might have 10% of the world's supply of uranium within its borders.

13. (U) The best studied region is the eastern steppe zone extending through Khenti, Sukhbaatar, and Dornod provinces. Results indicate that choicest deposits are found in Dornod, especially in the northern tier of the province in Dashbalbar soum (county). Specific totals for the most likely and currently best explored sites in Dornod: 1) Mardai - 56,000mt; 2) Gurvanbulag - 16,000mt; 3) and Mardain Gol - 10,000mt.

A Short History of Uranium Mining in Mongolia

14. (U) Mongolia has had on-and-off uranium exploration for four decades. The early phase, 1966-1990, was typified by the Soviet Union's need to secure Mongolian resources for its own purposes. The Soviet Union initiated basic exploration for uranium in Mongolia in 1966. These initial studies led to extensive radiometric surveys of Mongolia from 1974-74. These surveys uncovered the promising Mardai deposit and led to a massive 15-year long exploration program that included a substantial drilling along the northern tier of Mongolia's North Eastern border with Russia. In 1988, the Soviets started production at the Mardai site from the only deposit amenable to open pit mining. This uranium output was transported north by rail and milled at a Siberian factory. The Dornod town of Mardai was created to support this complex of exploration, development and production. Mardai's population peaked at 26,500 around 1990, making it Mongolia's fourth largest city at that time. To service the mine, the Soviets built a new rail branch line, several power lines from Russia, and provided a large, standby diesel-fuelled generating plant at the town site.

15. (U) The collapse of the Soviet Union and the withdrawal of all Russian support ended all exploration and mining activities for

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uranium by 1991. For all intents and purposes between 1991-2003 Mongolia's uranium resources simply vanished from the face of the earth. Both Russia and the GOM decided to mothball Mardai, and nothing happened at the site, except the gradual striping of such resources as could be sold as scrap to the Chinese. Despairing of this situation, the GOM decided to find a buyer for Mardai who would bring it back into production and restore the jobs and prosperity that had once visited the area. In 1997, the GOM prevailed on the Russians to join with them to sell a piece of their stake in Mardai --some 58% of the firm, with the Russians and the GOM retaining 21% each.

Current Exploration and Development Plans

16. (U) The majority holding in this mine, according to press reports, was purchased by American uranium processor and miner Wallace Mays, which held it in a joint venture with the Government of Mongolia and the Russian State-owned Priagunsky Company, which remains under the control of the Russian Ministry for Atomic Energy (MinAtom). Before Mays acquired Mardai, the deposit had been producing yellowcake through an in situ leach process. However, this deposit had played out and Mays would have to move to another open pit deposit located on the Mardai site, estimated to have seven years of production at a commercially viable rate. Collapse of uranium prices in the late 90s made investment in the new site unviable, but the steady rise of uranium prices has rekindled interest in Mardai. In order to get investment for bringing Mardai on line (and after nearly ten years in mothballs and pillaging, Mardai is a ruin), Mays joined with Canadian and other American companies to form Khan Resources (<http://www.khanresources.com>). Although the creation of Khan Resources has generated legal battles among the various shareholders, the firm is committed to mining uranium and producing Mardai yellowcake within the next two years.

17. (U) In addition to Khan Resources, several other western firms are actively engaged in exploring Mongolian uranium resources, although none of them have as ripe an asset as Khan Resources' Mardai. Among these firms are

-- Canadian Western Prospector with key prospects in the Dornod area;

-- Australian Mega Uranium with exploration sites in the south and central Gobi region;

-- French Areva (formally Cogma) through its 70% Mongolian JVC Cogegobi with Gobi exploration assets;

-- Canadian Dennison Mines (which recently acquired merged with the International Uranium Corporation, a Mongolian-Russian-American JVC), is actively pursuing prospects in the south-central Gobi region. Dennison is initiating a pilot mining project to test if a particular in situ leaching process can yield product economically. (Note: Negative experiences with chemical mining processes, including livestock die-offs, have raised environmental concern among authorities. Mongolian inspectors have little training and ability to control activities in many of these remote mining sites, often relying on firms to follow such laws and regulations as are on the books. In the case of Dennison, the company has drilled holes/wells into which they will pour chemicals that will allow them to study underground water flow patterns to ensure that their leach facility does not harm vital desert groundwater supplies.)

¶8. (U) Since 1991 the Russians have not engaged in any organized, wide scale exploration or development of Mongolia's uranium resources, leaving the field to western competitors. However, in line with Moscow's recent efforts to re-assert some control over developing Mongolia's resources, the Russians have recently signaled to the GOM that they want back in. On April 13, Director of Russia's Federal Atomic Energy Agency (FAEA) Sergei Kiriyenko met with senior Mongolian officials, including President Enkhbayar, and signaled unambiguously that Russia would be delighted to cooperate with Mongolia. Such cooperation might include mining and uranium production facilities, and even nuclear power plants. As with other recent lavish Russian offers (the US\$2 billion promise to restore

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the Mongolian rail system in return for mining rights, for example), the Mongolians have yet to sign any binding agreement.

¶9. (SBU) Chinese activities in the uranium field are murky. Local contacts in the mining sector have related how Chinese firms, including those associated with China's state nuclear authorities, have contacted them about acquiring uranium prospects. Our sources relate that these offers have come to nothing so far, but as companies may be concealing their beneficial owners, it is hard to tell in some cases who is actually buying.

The Legal and Policy Environment

¶10. (U) The recently amended minerals law of Mongolia has dramatically altered the environment for extracting uranium (ref A). The law specifically singles out uranium as a "strategic" mineral, mines of which the state may acquire up to 50% equity. The uranium exploration firms are aware of this provision, are not particularly comfortable with it, but agree that, if the GOM compensates them for what it takes, they will comply without too much struggle. GOM policy on uranium, much like its policy on other mining activities, is intended to ensure that Mongolia benefits from resource extraction.

¶11. (SBU) One impediment to development is the GOM's disorganized approach to regulating nuclear products production. The Ministry of Industry and Trade is charged with mining and extraction issues, but any production a product for power generation -- yellowcake and beyond -- is apparently the purview of the Ministry of Fuel and Energy. However, MIT and MFE both claim dominion over regulation, as they also do with coal. The Ministry of Nature and Environment and the State Special Inspection agencies are just beginning to consider their roles in regulating such an industry.

Environmentally, the legal and regulatory environment has a long way to go to be able to administer this part of the mining sector. Laws and rules remain obsolete or nonexistent, and the Mongolians routinely ask for guidance on how they can regulate this and other complex mining operations with their low resource base. Of course, the Mongolian National Security Council (President, Speaker and

Prime Minister) will have its say, too. Any potential miner would have to knock on many doors and would undoubtedly have to mediate conflicts among each GOM entity that wanted to add some bit of uranium to its portfolio. There seems no inherent impediment for untying this bureaucrat tangle, just attention from senior GOM politicos to order it done.

¶12. (U) In addition, to the environmental imperative, the GOM is committed to down-stream, valued added processing in Mongolia. As FAEA Director Kiriyenko tacitly recognized in discussing in-country processing, there is no question that the Mongolians expect to move up the value chain and plan to make doing so part of any investment agreement they make (as they did with the recent Oyu Tolgoi copper mine agreement - ref b).

¶13. (SBU) Some government officials have noted that Russian offers to take all of Mongolia's uranium off-take may be nothing more than a trick to control and undercut a competitor for uranium products, but they also wonder where any Mongolia-based firm, public or private, will sell its off-take: If not to Russia, then who can and will buy? And how to get it to market? Wallace Mays has often told us that he would like to sell Mardai's output to India, but this raises the issue of transshipment. The GOM tells us that the Russians have signaled that they would be loathe to allow shipment of uranium that they did not control, and the Chinese have made clear that they will not let uranium pass through their territory, unless it is bound for Chinese facilities.

GOM Attitude on Proliferation Issues

¶14. (SBU) In response to post's question regarding the GOM's current understanding and cooperation on proliferation issues, the GOM re-iterated the position set out in its 2004 letter to the UN, "National report of the Government of Mongolia pursuant to Security Council resolution 1540 (2004)" (full text below). Despite the

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GOM's sincere commitment to be a good nuclear citizen, it seems clear to us that the GOM has not yet institutionally considered the implications that producing uranium products and possibly generating power from the same might have on their non-proliferation commitments. However, some Mongolian officials have begun to consider and discuss the proliferation, political, and economic implications of uranium for Mongolia. (Note: The U.S. recently told Mongolia that we are interested in extending them assistance to help improve their ability to comply with UNSCR 1540, in response to Mongolia's request to the Security Council. Mongolia's request was largely focused on screening equipment at border points.)

¶15. (SBU) Mr. Daavadorj, who has been nominated to become the new Minister for Industry and Trade, told us that, given the heavy political baggage that uranium mining carries, he was eager to see U.S. involvement in the uranium extraction industry in Mongolia if only to ensure that international community recognized that Mongolia was being above board about potential yellowcake exports. He also expressed great hope for the economic return on uranium exports, saying that unlike copper and gold, which are expected to decrease in price over the medium term, the West's determination to shake its addiction to oil would mean increasing prices for the element critical for fueling nuclear energy into the foreseeable future.

¶16. (U) Text of "National report of the Government of Mongolia pursuant to Security Council resolution 1540 (2004)"

Mongolia continues to fully implement its obligations under the relevant multilateral agreements, such as the Treaty on the Non-Proliferation of Nuclear Weapons, the Biological and Toxic Weapons Convention, the Chemical Weapons Convention, the Comprehensive Nuclear Test-Ban-Treaty, etc. In particular, it is committed to the objective of eliminating the risk that non-State actors may acquire, develop, traffic in or use nuclear, chemical and biological weapons and their means of delivery. It has also undertaken necessary control measures aimed to prevent illicit trafficking in weapons of mass destruction, including the adoption of legislative measures and enforcement of appropriate sanctions for

the violation of such measures. Furthermore, as a strong advocate of nuclear-weapon-free zones, Mongolia declared its territory a nuclear-weapon-free zone in 1992 and is now working to further institutionalize its international nuclear-weapon-free status.

Mongolia has welcomed the UNSC resolution 1540 (2004) and is committed to its implementation. The Government of Mongolia, therefore, wishes to provide the following information.

Mongolia does not provide any form of support to non-State actors that attempt to develop, acquire, manufacture, possess, transport, transfer or use nuclear, chemical or biological weapons and their means of delivery. Such support would conflict with Mongolia's national legislation, its international obligations, and the foreign policy it pursues on the international arena.

Mongolia does not possess facilities for manufacturing or producing weapons and ammunition. It has never developed, produced, acquired, possessed or stockpiled, or otherwise had control over nuclear, chemical or biological weapons and their means of delivery.

These obligations are covered by the following legislative acts:

11. Law on Protection against Toxic Chemicals (1995) and the amendment thereto of 8 April 2000;

12. Law on Mongolia's nuclear-weapon-free-status (2000);

13. The Criminal Code of Mongolia (2002);

14. Law on Combating Terrorism (2004);

Mongolia fully complies with its obligations under the following international treaties and conventions pertaining nuclear, chemical and biological weapons, and advocates attainment of their universality and strengthened effectiveness.

-- Treaty Banning Nuclear Weapon Tests in the Atmosphere, in Outer

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Space and under Water (since 1963).

-- Protocol for the Prohibition of the Use in War of Asphyxiating, Poisonous or other Gases, and of Bacteriological Methods of Warfare (since 1968).

-- Treaty on the Non-Proliferation of Nuclear Weapons (since 1969).

-- Treaty on the Prohibition of the Emplacement of Nuclear Weapons and other Weapons of Mass Destruction on the Sea-bed and the Ocean Floor and in the Subsoil thereof (since 1971).

-- Convention on the Prohibition of the Development, Production and Stockpiling of Bacteriological (Biological) and Toxin Weapons and on their Destruction (since 1972). Mongolia fully supports the elaboration of an additional protocol to the Convention that will ensure effective legally binding verification of compliance with the Convention.

-- Convention on the Physical Protection of Nuclear Material (since 1986).

-- Convention on the Prohibition of the Development, Production, Stockpiling and Use of Chemical Weapons and on their Destruction (since 1995). A National Inter-Ministerial Task Force was set up to monitor and enforce implementation of the Convention. Refer to paragraphs 2 and 3 for the legislation and regulations adopted in the follow-up to Mongolia's accession to the CWC.

-- Comprehensive Nuclear Test-Ban Treaty (since 1997).

End text

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